I. Introduction

- The student loan sector, and public finance as a whole, has been lucky in that we have generally been able to devote our discussions of federal securities law that focused on specific emerging developments to single topics. We have been luckier in that these have been few and generally far between.

- I can remember making presentations to this group in 1994 on the need for boards and executive officers to have a chance to review the OS and to raise disclosure issues, in 2000 on then-new guidance on website disclosure and last month on the SEC’s Municipalities Continuing Disclosure Cooperation initiative (“MCDC”), and I am sure that I participated in discussions of the new continuing disclosure agreement requirement (in 1994) and the amended standards for event disclosure (in 2009) and of Dodd Frank’s municipal advisor provisions (in 2010).

- Over the past few years, however, and especially this year, the combination of Dodd-Frank implementation (beginning in mid-2010) and the SEC’s newly aggressive focus on the public finance market (dating from its 2010-2012 hearings and July 2012 Report) has resulted in an increased number of developments.

- I will try to use this time to describe some recent municipal securities law developments and what portfolio issuers and particularly general counsel should do about them.
These include: (i) the final Municipal Advisor Rule adopted this year; (ii) MCDC; (iii) the 2011 ABS Disclosure Rule which requires reporting as of January 1, 2015; (iv) the 2014 Rule AB amendments adopted this year; and (v) the State of Kansas cease and desist order. Let’s take them in that order. For those of you who may be involved in conduit deals, most references to issuer in the first two sections will apply as well to conduit borrowers.

**Municipal Advisor Rule (adopting release 11/12/13; effective 7/1/14)**

- There have been two rounds of negotiated interpretative questions and answers. These appear on the SEC website as “Frequently Asked Questions” and were most recently updated on May 19, 2014, adding 30 single spaced pages to the 777 double spaced page adopting release (not to mention the 60 Federal Register pages of the Proposing Release). The SEC was selective as to which proposed FAQs were addressed. The current understanding is that the staff is considering addressing a few additional points (most likely candidates being investment, and particularly governmental pooled investment programs) but are unlikely to add more detail to points already addressed.

- In essence, working group members may not offer “advice”, (which is generally defined as particularized explicit or implicit recommendations to issuers or obligated persons as to structure, timing or terms of municipal securities, or as to related derivatives or investments, and certain solicitations), unless registered as a municipal advisor or within a statutory exclusion or administrative exemption (except in response to a time-limited, competitive RFP process). This is a facts and circumstances determination and the SEC has explicitly reserved the possibility of interpreting it broadly.
Although the Rule does not directly regulate issuers, the Rule remains of concern because working group relationships and procedures are still in the process of evolving to accommodate its inhibitory effect upon communications between issuers and other working group members.

Municipal advisors are fiduciaries for their clients and are subject to SEC licensure and regulation.

The Underwriter Exclusion—the prohibition does not apply to communications by an underwriter within the scope of underwriting a particular issuance of securities. Underwriters may be expected to seek written evidence of engagement in conjunction with delivery of the MSRB Rule G-17 disclosures as to issue risks and the underwriter’s role. (While Rule G-17 process requires the underwriter to request acknowledgment it does not require that this be received and many issuers find acknowledgment without a reservation as to the statements of underwriter’s role included problematic) This exclusion does not include post-issuance activity such as determinations of materiality for continuing disclosure event notice purposes or remarketing (though remarketing agents may give issuers particularized factual information without a recommendation as to refunding or change in interest rate mode or credit or liquidity support).

The Public Official and Employee Exemption—nor does it apply to employees, board members or employees of a “state-level municipal entity” acting in their official capacities or scope of employment (or to anyone engaging as a member of the public in public discourse or process). It is possible that this exemption may not extend to all former employees who may currently be acting on a less formal advisory basis and
general counsel should review any such arrangements ASAP to avoid surprises.

- **The Bank Exemption**—the prohibition does not apply to communications by banks about their own extensions of credit or investments held by them. This, combined with the advice standard, should cover a range of trustee communications, but should be expected to influence trustee willingness to address certain issues. It will also not apply to direct non-bank institutional purchaser communications of the terms and conditions of the securities that they will purchase.

- **The Attorney Exclusion**—nor does it extend to attorneys “offering legal advice or...services ...of a traditional legal nature with respect to the issuance of municipal securities or municipal financial products...to the attorney’s client... in the transaction.” This may include some degree of negotiation and is limited by rules of professional conduct applied to the traditional practice of law in the area of municipal finance. (ft.nt. 818).

- **The IRMA Exemption**—None of this applies to communications constituting advice as to matters within the scope of an independent registered municipal advisor’s retention, provided that certain representation and disclosure requirements are met. Issuers who wish to permit their working group members to rely upon this exemption must be attentive, however, to the scope and timing of the IRMA’s retention and to making the required representations to working group members.

- Currently, issuers should be aware of the basis of each working group member’s compliance, any resulting
documentary requirements and resulting limitations on the scope of their communications. Issuers should develop their own policies and should be aware of any State policies as to their underwriter and municipal advisor relationships. I would suggest that general counsel participate in identifying what effect the Rule and such policies may have on working group dynamics and the availability of information and advice, in discussion of whether to retain a municipal advisor and in reviewing documentation, (including RFP’s, IRMA notices, G-17 notices). RFP reliance may be especially problematic in view of State procurement requirements.

- Although most of the focus so far has been on what effect the Rule has upon underwriters, we are at the beginning of a new regulatory class and it is foreseeable that evolving municipal advisor documentation requirements may also require general counsel attention.

- The principal goal of this Dodd-Frank provision was to create a structure for municipal issuers to receive advice from advisors who would act subject to SEC licensure and regulation and a statutory fiduciary duty. It remains to be seen to what extent the SEC, or States, will develop policies that favor, or even presume, IRMA involvement.
MCDC (issuer deadline Monday December 1, 2014)

- The MCDC Initiative invites municipal issuers and their underwriters to voluntarily self-report a specific type of issuer disclosure failure during a brief window in order to avoid the risk that SEC enforcement against the submitting entity with respect to that failure might otherwise result in harsher penalties.

- It is important to note that:
  - the Initiative does not address any other disclosure or securities law issue, including any issue that may come to the SEC’s attention as result of a submission;
  - the Initiative only addresses entity exposure and does not address any individual exposure; and
  - the Initiative does not shield an issuer from private disclosure based actions or other regulators, a submission is probably discoverable and the SEC may use information obtained from issuers and underwriters pursuant to the Initiative for its enforcement purposes and may share this information with federal and state regulators and others.

- The specific type of disclosure failure that the Initiative does address is the fact pattern of an issuer having made “materially inaccurate statements in a final official statement regarding [its] prior compliance with [its] continuing [disclosure] obligations… under Rule 15c2-12.” It is important to note that omission of material information may cause a statement to be deemed materially inaccurate.
• The window for submission was originally through midnight on September 9, 2014 for both issuers and underwriters. This was extended to December 1, 2014 (plan on Tuesday, November 25, which is 41 business days) for issuers (and obligated persons) only. Further extension is unlikely.

• The reduced penalty incentives for submission are different for issuers and underwriters. For issuers, submission may result in a cease and desist order based on negligence, without financial penalty or admission of intent or recklessness, but with other very important consequences. For underwriters, there are also financial penalties, which are capped on an aggregate basis so that the largest number of submitted issues that would cause an underwriter to reach its cap is 25.

• Requirements for issuers include that the issuer must: submit entity and lead individual contact information for itself and most of its working group; agree to accept settlement terms proposed by the SEC; establish “appropriate” continuing disclosure policies and procedures and training within 180 days of settlement; correct all delinquent continuing disclosure filings within 180 days of settlement; cooperate in any further SEC investigation of the false statements (including investigations of other parties and individuals); and provide the SEC with a compliance certificate on the settlement anniversary (Note that false testimony or certification may be a serious penal offense), as well as disclose the settlement in any new Official Statement to be published within 5 years. Effectively, this can be thought of as the issuer placing itself under SEC jurisdiction with respect to continuing disclosure matters.
The technical basis of the disclosure failure being deemed to violate federal securities law is also different for issuers and underwriters. Rule 15c2-12 is directly applicable to underwriters, not issuers, and requires underwriters to: (i) reasonably determine that there has been a written contractual undertaking to provide specified secondary market disclosure; and (ii) review a final official statement prior to offering to buy a covered bond. The Rule defines an “official statement” to require disclosure “of any instances in the previous five years in which each person identified in the Official Statement as undertaking to make continuing disclosure pursuant to the Rule] failed to comply, in all material respects with any previous [written Rule 15c2-12] undertakings”. For issuers potential enforcement is based upon the general federal securities law antifraud provisions.

The date of publication universe of final Official Statements that are of concern is generally thought to be 5 years, tracking the general federal statute (28 USC 2462) limiting proceedings for civil enforcement - 11/30/09. It should be noted, however, that not all States have similar statutes of repose with respect to their securities law enforcement. Cease and desist orders under federal securities law may give rise to state enforcement actions and, potentially, private lawsuits.

The issue that is of concern is whether a statement addressing a continuing disclosure undertaking under Rule 15c12-2 that appeared in a final Official Statement published during that period was “materially inaccurate” as to compliance, “in all material respects”, with prior continuing disclosure undertakings. Generally, the date of noncompliance event universe for continuing disclosure is thought to be 5 years prior to an Official Statment, based on the Rule requirement
that an issuer disclose prior noncompliance within that period.

- The term “materiality”, which is at best a term of art, is used here in two different contexts that affect its meaning. In contrast to most discussions of materiality that most issuers have experienced, avoiding the determination through overinclusion has significant costs in this case.

- The capped financial penalty created an irresistible incentive for underwriters to err on the side of submitting and it is reliably estimated that major underwriters may have submitted no less than 15-20% of the publicly issued deals that they brought to market during the 5 years ending September 9, 2014. To put this in perspective, Thomson Reuters lists a total of about 57,000 publicly offered issues during this period (of which about 19,000 had underwriters counsel). Even taking into account that some of these were variable rate demand notes issued before December 1, 2010 that were not subject to continuing disclosure undertakings, or were otherwise exempt, this suggests that the SEC received submissions with respect to a very large number of issues (10,000 may prove conservative).

- Thus far, the SEC staff has confirmed that they intend to review these submissions on an issue by issue basis, to make their own judgment as to whether a cease and desist order is appropriate and to recommend MCDC enforcement actions with respect to submissions as their review of that submission is completed. Their review may involve additional investigation, including requesting information from issuers.

- As noted earlier, the staff is not precluded from investigating additional matters relating to issues that have been submitted.
The staff has also confirmed that they have developed a review protocol. Although pressed repeatedly to release their materiality criteria, (most recently by my partner John McNally, among others, at last week’s NABL Bond Attorneys’ Workshop), they have so far refused. As cease and desist orders become public, it may become possible to make some inferences as to the staff’s criteria, but this will take months and the issuer submission deadline is only about 43 business days away.

- We have of necessity been developing our own internal materiality criteria (as have other firms that have been struggling with MCDC materiality issues). John McNally also acted as the principal draftsman of NABL’s, the National Association of Bond Lawyers released on August 5 a paper titled “MCDC Initiative Considerations for Analysis by Issuers of Materiality and Self-Reporting”, which attempts to state a basic framework for determining whether an Official Statement representation as to prior continuing disclosure undertakings is materially misleading and, if so, some factors the issuer should consider in determining whether to make a submission. I would be happy to send a copy to any of you who send me an e-mail at kroberts@hawkins.com.

- Issuers who have not already done so should immediately determine if any of their underwriters have made submissions that include any of their Official Statements that were published (or republished) within the five years ending September 9, 2014 and, if so the basis therefor. Whether or not a submission was made, they should also ask for a description of the review method and of any continuing disclosure noncompliance that was not submitted and, if possible, a copy of the underlying search results.
• If one or more underwriters have made submissions that include one of an issuer’s Official Statements, the issuer must determine whether it wants to also make a submission, state its disagreement or provide information as to the facts and circumstances to the SEC staff without making a submission, attempt to persuade the underwriter to amend its submission or take no action. This is a highly fact specific judgmental determination. It is also a very important one as Enforcement Division staff has indicated that if the issuer doesn’t submit in such a case and the underwriter’s submission is accepted, they will consider a separate enforcement action against the issuer.

• Factors that might be taken into account in a particular case include: the basis for submission; the timing and other additional facts that may have influenced the issuer’s original continuing disclosure performance or that influenced subsequent statements about that performance; changes in its continuing disclosure practices; the number of continuing disclosure noncompliance events, what the issuer did when it discovered them and the issuer’s risk profile with respect to the Official Statements, including the possibility of state or private actions.

• Whether or not any of the issuer’s Official Statements have been included in an underwriter submission, the issuer must make its own independent review, unless it is entirely confident that it can rely upon its files. SEC Enforcement Division staff are doing their best to state that they expect issuers to do this.

• As there is no riskless alternative, issuers should be completely confident that they know the facts relating to the timeliness and adequacy of their annual and event continuing
disclosure dating back to five years prior to the publication date of the first Official Statement published or republished in the five years ending November 30, 2014.

- How much review this will require depends on the number of deals an issuer has to worry about, the number of events it experienced that may have required disclosure and how good its records are. Issuers with a large number of issues or less than complete records should consider hiring a specialized service provider such as DAC (www.DAC_Bond.com”) to review their filings.

- In any event, the issuer and the trustee must be the source of information as to the occurrence of events that might have triggered required disclosures and the rationale for disclosing or not disclosing. This is complicated by the 2010 Rule amendments which changed the minimum required events subject to disclosure and limited issuer discretion as to materiality and timing. It is further complicated for some issuers by their voluntary inclusion of additional disclosure undertakings in the Continuing Disclosure Agreements or by their use of EMMA for voluntary disclosure (ie. not required by any undertaking), especially during and after the auction market collapse.

- If continuing disclosure noncompliance events are identified and have not been adequately disclosed, issuers must balance the risks of submitting, of taking other actions and of taking no action. Many of the same considerations may apply.

- Although these decisions obviously involve business judgment, the process as obviously must involve general counsel. This is especially true as the MCDC process only protects the issuer as an entity and not individuals. Time for
consultation with outside counsel, boards or oversight entities should be built into this schedule. In certain cases, it may make sense to provide for board review (for instance by an audit committee) of the report results. Board approval may be necessary. In any event, issuers should be prepared to defend decisions.

- To date there has only been one order (which as a preexisting enforcement action doesn’t count), but there will be many more and issuers are likely to be asked for the rationale that led to their decision of whether or not to make submissions. We reviewed and evaluated is a better answer than we relied on our underwriter.

- The behavioral change that the SEC is seeking through this exercise is issuer adoption of continuing disclosure training and production procedures susceptible to documented compliance verification.

- As portfolio finance programs (absent unusual markets events), student loan continuing disclosure requirements lend themselves to the development of manageable procedures. Issuers who have determined that they do not have existing continuing disclosure compliance disclosure concerns, or who make a decision to not resolve any such concerns through a submission, might nonetheless be well advised to voluntarily implement documented secondary (and for that matter primary) disclosure training and production procedures, without accepting the binding force of a cease and desist order and becoming subject to SEC approval of the procedures (and subsequent changes) and the risk of possible serious sanctions if the order is later deemed violated as a result of a failure to follow such procedures. In this connection, it should be noted that the SEC has consistently
stressed its belief in the importance of such procedures since the 2006 *City of San Diego* order and has insisted upon them as a feature of all subsequent settlements. Hawkins was the firm that developed the San Diego policies and procedures that have been adopted by the SEC as a standard and we have since assisted a number of significant issuers in implementing such procedures.

- This is not a situation for one size fits all advice, beyond that issuer’s should already be determining or confirming the facts relating to the specific OS representations that they have made over the past 5 years as to their continuing disclosure compliance and, if the facts suggest consideration of a submission, should consult with competent counsel with specific expertise in municipal securities disclosure regulation.

- There is not a lot of time. The submission deadline is less than 45 business days away and follows a holiday weekend. We won’t know the timeline for SEC staff review of issuer submissions until after this deadline. After a submission is accepted, the issuer will only have 180 days to implement procedures and issuers who do expect to make submissions may be well advised to begin reviewing or implementing their continuing disclosure procedures without waiting for this clock to start

- Adoption of continuing disclosure procedures as a result of a cease and desist order changes its regulatory force as subsequent violation is a violation of the cease and desist order (*City of Miami*)

- To be successful (not to mention to control cost), such procedures should be rooted in an issuer’s budgetary and control process (they also should not be one size fits all) and
there can be no assurance as to the SEC’s willingness to: (i) accept preexisting procedures; (ii) consider individualized procedures “acceptable”; or (iii) approve future amendment of such procedures.
2011 ABS Disclosure Rule (adopting release January 20, 2011, first required disclosure February 14, 2015, with respect to three years ending December 31, 2014)

- Section 943 of Dodd Frank amended the 1934 Act to require issuers of what the SEC now refers to as 1934 Act ABS that include covenants to repurchase underlying assets to disclose “unfulfilled and unfulfilled repurchase requests”.

- Municipal securities were not exempted from the resulting Rule, but its effective date was delayed by three years for a category of “municipal securitizers” that includes, at least, “States, United States Territories, The District of Columbia and any political subdivision of public instrumentality of any of these”.

- Municipal securitizers that have undertaken such covenants must file the required information through EMMA. The first filing must be made by February 14, 2015, with respect to three years ending December 31, 2014, and quarterly filings are required thereafter with respect to the prior quarter. In addition, new issue disclosure must include information with respect to the prior three year period.

- Issuers that are municipal securitizers need to have systems that capture repurchase and replacement demands and their disposition for the required period and to effect these EMMA filings and primary offering disclosures.

- The Rule required a filings by other securitizers commencing February 14, 2012. Issuers that are not municipal securitizers and have not been complying should consult with counsel immediately.
Rule AB (adopting release published September 24, 2014; effective November 23, 2014 or, with respect to loan level disclosure, November 23, 2015)

- This is a fairly sweeping revision to the registration and disclosure requirements for shelf registered ABS in certain asset classes.

- The amended Rule is primarily directed to giving institutional ABS investors the ability to perform their own portfolio analysis prior to acquisition and periodically thereafter rather than relying on rating agencies. More generally it may be described as an effort to decouple the registered ABS market from rating agency dependency.

- Even a cursory review of the Adopting Release gives the impression that the effort is predominately directed at registered private label real estate mortgage backed securities, a market that has shrunk from $820 billion of new issuance in 2004 (before the very high volumes immediately prior to the fiscal crises) to $57 billion in 2013.

- The Rule is only directly applicable to registered ABS with real estate, auto, debt security and resecuritization portfolios. Other registered ABS classes, including student loan portfolios, may be the subject of further rulemaking. The adopting release states “For those asset classes where we are deferring action, we will continue to consider the best approach for providing more information about underlying assets to investors, including possibly requiring asset level data in the future.” For non-registered ABS, this is primarily of interest as potentially creating market pressure for voluntary conformance.
• This may particularly be the case if the requirement is extended to registered student loan ABS. The Adopting Release noted that SLMA and ASF comments had distinguished student loan pools on the basis of the large number of loans (ft nt 167). Student loan pools remain a very small fragment of the very dramatically reduced post-liquidity crises registered ABS market.

• The principal innovation is a requirement that specified asset-level data be provided in eXtensible Markup Language ("XML"). Different data points were required for different covered classes. This is coupled with a 3 business day minimum offering period, with minimum 48 hour filing of material changes.

• A large number of specific data points are required. Some of which are common to all covered asset classes and others are asset class specific. New Schedule AL fills 12 pages of the Federal Register.

• The maximum prefunded amount was also reduced from 50% to 25%, instead of 10% as proposed. Proposed reduction of recycling from 3 to 1 year and limitation of the use of master trusts to accounts were not adopted.

• The Rule also requires a multi-stage repurchase demand resolution process. This is in part in response to a finding (based on initial Rule 15G-1 reporting) that “more than 99% of repurchase requests are in dispute” and that only 16.5% of those resolved resulted in repurchase, with the rest being withdrawn or rejected (ft nt 1048). This is supported by holder communication provisions.

• Issuers should watch this space for developments. To the extent that they voluntarily adopt some of the requirements
for registered shelf ABS deals, they should consider that this approach is based on the assumption that investors are able to analyze the data provided. While that may well be true of the investors for the relatively small set of registered ABS deals since the fiscal crises, it has not historically been true of many public finance investors market. This may lead to consideration of restricted sales to exclude retail buyers or improving disclosure to advise them of the disparity in other investors’ ability to rely upon their own modelling of disclosed data rather than upon rating agency evaluation.
State of Kansas Cease and Desist Order (released August 11, 2014)

- On its face, this order appears to be a continuation of a series of cease and desist orders based upon findings that general governmental entities failed to adequately disclose the status of pension obligations similar.

- This order has also received some attention based on the fact that the State of Kansas was not the actual issuer, but rather the benefitted party and that the conduit issuer does not appear to be a party to the enforcement action. This has been taken by some as suggestive of the SEC’s likely treatment of conduit issuers in connection with MCDC submissions involving continuing disclosure failures by their conduit borrowers.

- Less attention has been paid to the order’s discussion of a risk factor that the conduit issuer added to its disclosure which appears to reflect a very restrictive view of the efficacy of generally stated risk factors that are not supported by specific data if the risk is sufficiently likely to accrue. While pre-existing case law supports the principle in a factual situation where the accrual of the eventuality was expected, the view expressed in this order aggressively applies it to the complex actuarial projections applicable to pension funding while apparently ignoring contemporaneous legislative reforms.

- Issuers should adopt the practice of actually reviewing their risk factor language both for applicability to each deal and for the possible need for more detailed and specific disclosure. In view of the need to consider much of this language on the basis of detailed knowledge of the issuer’s affairs and an appreciation of the disclosure requirements,
this review should involve and be coordinated by general counsel.

- In the Kansas situation, the basic facts were available to the working group. This may well not be the case for some risk factors.